No. 104

In the
Supreme Court of the United States

October Term, 1967.

ALEXANDER TCHEREPNIN, et al.,
Petitioners,

vs.

JOSEPH E. KNIGHT, et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

REPLY BRIEF FOR ALEXANDER TCHEREPNIN, ET AL.

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The Scheffer Press, Inc.—ANdover 3-6850

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The briefs filed by respondents demonstrate that petitioners' position is unassailable. They do not attempt to gainsay the accuracy of any except a very minute part of petitioners' array of facts and of statutory and case law. The details of the formal and of the substantive characteristics of the investment interests here under consideration, as so depicted by petitioners with precision, are thus virtually undisputed.[1]

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[1] Where respondents occasionally raise a question of accuracy, the sources cited in petitioners' brief establish that it is respondents and not petitioners who have misread the Illinois Act as well as cases cited, and are in error. For copious examples of errors by respondents in reading text and misapprehension of meaning of cases, cf., Petitioners' Reply to Respondents Brief In Opposition to the Petition for Certiorari; also compare current briefs.

Yet, respondents virtually ignore these legal realities. They argue *inter alia* that the substance of the investment relationship here is that of a creditor-debtor indebtedness, which both the Illinois Savings and Loan Act, Ill. Rev. Stats. (1963) c. 32, §§ 701-944, (hereafter "the Illinois Act") and the Illinois Supreme and Appellate Courts say it is not. *Gorham* v. *Hodge,* 6 Ill. 2d 31, 41, 126 N.E. 2d 626, 631 (1955); *Marshall Savings & Loan Association* v. *Henson,* 78 Ill. App. 2d 14, 222 N.E. 2d 255 (1966) (Pet. Br. 21, 23, 28).

Such shares and share accounts of an Illinois association are creatures of the Illinois Act. The Act constitutes enabling and restrictive legislation for the purpose of promoting thrift and home ownership through investment in such associations. It specifies in intricate detail that these interests are capital shares and share accounts, both by name, (§ 761)[2] and by careful delineation of substantive characteristics (Pet. Br. 4-11, 18, 20-24).

I.

Underlying Equities Cannot Influence The Determination Of Whether Or Not These Capital Shares Are A "Security", But In Any Event No Inequity Exists.

Respondents seek to reject all of that as mere formalism, along with the contracts under which these investments were sold to petitioners as alleged in the Amended Complaint, which allegations stand admitted before this Court for present purposes. This case is here on writ of certiorari as the ultimate result of an interlocutory appeal by the present respondents from the trial court's order denying respondents' Motions to strike or dismiss the

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[2] Citations by section number only are to the Illinois Act.

Complaint for failure to state a cause of action. It is that order sustaining the Complaint which was properly before the Court of Appeals, not the Answers to the Complaint, and the controlling questions involved in that order are those set out in the Petition for Writ of Certiorari granted by this Court.

Accordingly, respondents' Answers to the Complaint included by them in the record in the Court of Appeals and here are mere make-weight and are not before this Court. The Court of Appeals committed serious error in accepting as true the self serving and untrue statements of alleged facts in the Answers, creating a background of untrue and prejudicial notions which that Court expressly referred to in its opinion, and in that false context held that the investment interests here involved are not a "security" within the meaning of § 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C., 78 c (a) (10)) (hereafter "the 1934 Act").

In their briefs here, respondents, as in the Court of Appeals, again argue the untrue and inflammatory allegations of their Answers as though they were established facts after a trial on the merits. The Answers incorrectly state that a lawful "voluntary" liquidation is pending; that respondent liquidators were elected in a meeting lawfully conducted; that a plan of voluntary liquidation was lawfully adopted; that the state officials are mere stakeholders here; that they stand ready and willing to and are lawfully carrying out their duties pursuant to Illinois law in the liquidation of City Savings Association (hereafter CSA); that unfairness or hardship would result from a holding by this Court that these investment interests are a "security" within the scope of the anti-fraud provisions of the 1934 Act; and that petitioners were not defrauded.

All these are issues properly to be resolved at the trial level. At that time petitioners expect *inter alia* to prove that they were defrauded in the purchase of these investment interests, as charged in the Complaint; that in fact petitioners could not withdraw their money at will, because CSA enforced the contract restrictions against withdrawals by fraudulently concealing facts which gave rise to the purported statutory right to withdraw at will, and that CSA did not have the cash with which to honor, and refused to honor the withdrawal requests of petitioners even in those instances when such requests were made; that the proxies solicited for the meeting to authorize the so-called "voluntary" plan of liquidation and to elect the liquidators were unlawfully solicited through fraudulent misrepresentations; that under Illinois law it is legally impossible to have a "voluntary" liquidation without Court supervision in situations, as here, where the savings and loan association is insolvent in the sense that its assets are substantially less than the claims of its creditors and investors; that the pre-1959 investors will not be treated inequitably if petitioners prevail, and that *in fact a substantial part of petitioners' money has already been paid to those pre-1959 investors.* (R. 39).[3]

Except as alleged in the Complaint, all such matters are totally irrelevant here.

With the allegations of the Complaint taken as true, it is grotesque for respondents to posture here that in-

[3] In due course the Complaint will be amended to enlarge the relief sought against particular defendants, as warranted by information discovered since this action was filed. Respondents took an interlocutory appeal from the order denying their motions to dismiss. They erroneously assume that any relief sought on the trial will be limited to the present prayers of the Complaint.

equities would result to other investors in CSA if petitioners are granted relief. The remarkable result of respondents' argument would be that any corporation, whether a savings and loan association or engaged in another business, whose assets have been lost through adversity, or have been pilfered or dissipated by dishonest management, could with impunity sell a quantity of securities by fraudulent and manipulative devices and thereby replenish the corporate coffers. Assuming the fraud is committed only by the officers, the shareholders as innocent beneficiaries of the frauds, but beneficiaries nevertheless, could hardly assert in a court of equity that their innocence, co-equal with that of the defrauded new investors, would make it a hardship on such shareholders to forego the fruits of the fraud committed by their corporate officers.

Respondents use the term "priority" as though it denoted an evil or inequitable device. In truth, preferences and priorities are tools of equity.

Aside from the preference which the law consistently gives to the victims of fraud to have restitution of their money as against those whose agents perpetrated the fraud, no matter how innocent the principals of those perpetrators may be, this inflammatory irrelevancy persistently pressed by respondents in the Court of Appeals and here cannot stand scrutiny in the light of established legal precedent. It is to be remembered that this action is a suit for rescission in a court of equity. For a century this Court has held that courts of equity must apply the rule of absolute priorities and may not resort to notions of curbstone justice to realign the rights of parties in equity reorganizations. The principle is equally applicable here. (*Chicago, R.I. & P. Railroad Co.* v. *Howard,* 7 Wall. 392 (1869); *Northern Pacific Railway Co.* v. *Boyd,* 228

U.S. 482 (1913); *Case* v. *Los Angeles Lumber Products Co.,* 308 U.S. 106, 60 S.Ct. 1 (1939)).

Respondents contend that the only distinction between petitioners and other investors in CSA is based on the historical date when they became investors. That would be true *only* if the allegations of the Complaint are to be completely ignored, for it alleges that petitioners are persons who were defrauded in the purchase of their investments through misleading and deceptive representations. In this respect petitioners and investors similarly situated are in an entirely different situation than those investors who were not so deceived.

Of course, all of that is really irrelevant. On the trial it will be necessary for petitioners to establish the allegations of the Complaint. The same is true as to the "persons similarly situated" in the class represented by them, as indicated in the Complaint. (Last sentence, ¶23, Rec. 12). Petitioners purchased their shares in CSA since July 23, 1959 (Rec. 4-5). Investors in CSA prior to that day were those persons who had been on a restricted pay-out basis since about 1957, so that as to the money they already had invested and any new money thereafter invested by them in CSA, they were knowledgeable (Rec. 10-11, Complt. ¶21) and thus undeceived in the sense of Section 10(b) of the 1934 Act, as distinguished from those post-July 23, 1959 investors who were not so knowledgeable.

The Complaint here by Petitioners is brought in their own behalf and on behalf of other persons similarly situated. The persons qualifying within the class necessarily remain indefinite until determined by the trial court. (See Rule 23(c) FRCP). Whether any of the investors in the post-1959 class were privy to knowledge of the true

material facts, as were the pre-1959 shareholders, remains for that court to decide.

II.

Respondents Concede That These Capital Shares Fall Within Several Descriptive Categories Of What Constitutes A "Security".

Petitioners' Brief establishes on the basis of the investment contract between the investor and City Savings Association (hereafter "CSA"), that the investments here are a "security" for federal purposes within the definition of that term in §3(a)(10) of the 1934 Act, 15 U.S.C., §78c(a)(10). This is supported by the detailed provisions of the Illinois Act and by what this Court has held to be the substance of the investment relationship which qualifies an instrument to be a "security" under the Securities Act of 1933 (28 USC §77a *et seq.*) (hereafter "the 1933 Act"). Specifically, they are a "stock," "certificate of interest or participation in any profit-sharing agreement," "transferable share," "investment contract," and, in addition, are "commonly known as a 'security.'"

Respondents' Briefs do not directly answer petitioners' as to three of these descriptive designations, *i.e.*, "certificate of interest or participation in any profit-sharing agreement," "transferable share" and "investment contract." Apparently, they have placed their hopes on somehow convincing this Court that these investment interests are not "stock," and are not "commonly known as a security" or were intended by Congress to be excluded from the benefits of the civil anti-fraud remedies under the 1934 Act. Even, *arguendo,* were these not "stocks" or "commonly known as a security," no one designation in the definition is a limitation or restriction upon any other (Pet. Br. p. 19), so that the three undisputed designations would still apply.

Respondents have seized upon peripheral, minor and irrelevant similarities to other situations and argue that those are "overwhelming" and controlling, both as to the substance of these investment interests and of the investment relationship. Respondents also allege fancied but non-existent distinctions between these and other investment interests which are admittedly within the scope of "security" as defined in §3(a)(10) of the 1934 Act. (CSA Br. 9-10; Knight Br. 8).

The bulk of their briefs consists of irrelevant digressions. Therefore, correction of all the profuse errors committed by them in the course of these digressions is unnecessary, and this Reply Brief, for the most part, is limited to pointing out the major errors upon which their arguments are based.

As heretofore stated, respondents contend that the interests before this Court involve a creditor-debtor relationship. Their argument is not responsive to Petitioners' brief and the authorities therein relied on (p. 22-24). Assuming *arguendo* that such a relationship was involved, respondents' considerable effort to persuade this Court that these interests are for that reason "excluded" from the scope of the 1934 Act is misdirected.

This entire argument of respondents rests on the fact that the phrase "evidence of indebtedness" appearing in the definition of "security" in the 1933 Act[4] does not

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[4] Section 2(1) of the Securities Act of 1933 defines "security" as: "(1) the term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certif-

happen to appear in the 1934 Act definition. Respondents have failed to note that in the 1933 Act definition the expressions employed to designate the various investment interests included under the definition of "security" overlap each other to a substantial extent. The same overlap characterizes the expressions employed in defining "security" in § 3(a)(10) of the 1934 Act. Almost the same terms are used in both definitions.

In the present case at least five descriptive expressions found in both definitions include the interests here involved. Assuming *arguendo* that "evidence of indebtedness" also described these interests, which it does not, the mere unexplained omission of that expression from the definition in the 1934 Act cannot be construed to exclude these interests from coverage by the other five terms. There is a great difference between an intent to omit a particular descriptive phrase and an intent to exclude everything that phrase might designate, or everything having an alleged peripheral similarity thereto.

If such omission were equivalent to intent to exclude, a blueprint for committing fraud would exist. Although other descriptive expressions in the definition are broad enough to include most evidences of indebtedness (also a "note", "bond" or "debenture," which are specifically included under the 1934 Act by name), anyone desiring to escape the 1934 Act would need only dress up his

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[4] (Continued)

icate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." (15 U.S.C. § 77b(1)).

investment securities as such other types of evidence of indebtedness and claim the alleged exemption.

It must be further noted that respondents admit that the Congressional history of the 1934 Act provides no explanation for omission of the phrase "evidence of indebtedness" from the 1934 Act definition. Mere random speculation as to the reason for omission of one descriptive term is not authority for removing from the reach of the 1934 Act an investment interest designated by five other descriptive expressions in the Act's definition.

In short, respondents contend that the unexplained omission of one of six independently adequate descriptive terms, assuming *arguendo* that "evidence of indebtedness" did here apply, establishes Congressional intent to exclude any interest qualifying under the remaining descriptive terms because it is within the ambit of the omitted phrase. It seems more logical that if Congress intended to exclude a particular kind of security it would have so stated in § 3(a)(10) of the 1934 Act at the point that it expressly provided that the term "security" shall not include "currency" and short term commercial paper. In Section 3(a)(12) Congress expressly exempted certain investment interests, but neither investors' interests in savings and loan associations nor evidences of indebtedness are among those exclusions.

It is patent that nowhere in the 1934 Act or in its Congressional history is there any express or implied exclusion of the investment interests here under consideration from the definition of "security", or any indication that the terms "stock", "transferable share," "investment contract," "certificate of interest or participation in any profit-sharing agreement," or "any instru-

ment commonly known as a 'security'" were to be narrowly rather than liberally construed as in all remedial legislation. Likewise, except as to short term commercial paper, a medium of investment activity historically limited in practice to participation by experts, there is no express or implied exclusion of any debt investments. Respondents' efforts to transmute the equity capital interests here involved into a debtor-creditor relationship are really much ado about nothing.

III.

Section 2 Of The Securities Exchange Act Of 1934 Has Been Misinterpreted By Respondents, But Correctly Read Manifests The Necessity For Regulation Of All Transactions In All Securities On Or Off Securities Exchanges. The Operative Sections Of The Act And Its Preamble Plainly Apply to All Securities Transactions.

The CSA Brief (p. 15) alleges that exclusion of savings and loan shares arises by implication from Section 2 of the 1934 Act. That section is set out in full at pages 1-2 of the Appendix to the CSA Brief. Respondents' reliance on Section 2 is based on a misconception of what the words "over-the-counter markets" mean. The Congressional committee reports on the 1938 amendment to the 1934 Act state that, "Under the Securities Exchange Act of 1934, the over-the-counter markets are deemed to include *all transactions* in securities which take place otherwise than upon a national securities exchange". S. Rep. No. 1455 at 2 and H.R. Rep. No. 2307 at 2, 75th Cong., 3rd Sess. (1938) (emphasis supplied).

Professor Loss states that, "Moreover there are positive indications both in the Exchange Act and in its legislative history that, unless the contrary appears in a particular section, the statute's scope extends to *all transactions* in securities". (Emphasis added). 3 Loss,

Securities Regulation (2nd Ed., 1961) 1467, citing 78 Cong. Rec. 7861 (Rep. Lea) and 8296 (Sen. Steiwer).

There is no policy explicit or implicit in Section 2 of the 1934 Act which would tend to remove a withdrawable capital share in a savings and loan association from the Act's operation. Section 2 is entitled only, "Necessity for regulation" and it includes no definitions, exclusions or exemptions. At the outset it states that in the national interest it is necessary to regulate and control "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets . . . [and] practices and matters related thereto, . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective. . . ."

Keeping in mind the comprehensive meaning of "over-the-counter markets," it is difficult to conceive broader or more inclusive terms to identify the extent of the subject matter included in the scope of the statute, or to express the opinion of Congress as to the necessity for comprehensive regulation and control with respect to any and all transactions in securities on or off any securities exchange. A multiplicity of reasons why transactions in securities are affected with a national public interest is listed in Section 2. If this section were definitional as to, or a limitation upon, which securities are covered by the Act, and if every reason therein cited would have to potentially apply to every security claimed to be subject to the Act, one would be hard put to find many securities to which it would be applicable. The proof required in each case would be monumental if not prohibitive.

Unambiguous terms of the Act's definition of "security" are to be liberally construed and it would be in-

consistent with the dominating general purpose of the Act to limit the definition by intruding on it, as to each security, the requirement that the entire list of particular circumstances which occasioned passage of the Act, must apply to that security. Moreover, many of the reasons cited in Section 2 *do* apply to the investment interests here under consideration.

As in the Court below, the CSA Brief selects a few lines of Section 2 and adds the word "when", which does not appear in the actual text, to support its position that the Act applies only to a narrowly specified situation. This excerpt including the interpolated "when", they argue, is a "clear expression of Congressional intent . . . that the Act was designed to cover *only* those securities which are negotiable and for which a fluctuating market exists." (Emphasis added). (CSA Brief, p. 15.). First, no requirement of negotiability, as distinguished from transferability by assignment, is either expressed or implied in Section 2.

Second, if the 1934 Act were not to apply to a security without a fluctuating market, all newly issued and unseasoned securities where there is no general information as to their market value, would be excluded. In such situations truthful disclosure is especially important. Fraud could be rampant in the early years of any enterprise, such as the tung-tree case, if the intended federal remedy were not available.

It is common knowledge that the total quantity of securities registered on national securities exchanges or for which a "fluctuating" over-the-counter market exists constitutes only a portion of the total securities involved in the national economy. Those of the vast majority of enterprises constituting the meat and sinew of our economy

are little known and little traded. If the transactions in such securities involving use of the mails or interstate facilities are to be interpreted as not covered by the anti-fraud provisions of the 1934 Act and the victims of fraud in such transactions are thus to be deprived of their civil remedies, a significant portion of the economy would be affected.

Indeed the first private remedy decision under rule 10b-5, as well as many subsequent decisions allowing recovery, involved the securities of closely held companies for which there was no fluctuating market. *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, E. D. Pa. (1946); *Kohler* v. *Kohler Co.* 319 Fed 2d 634 (1963) 7th Cir.; *Taylor* v. *Janigan*, D. Mass., Civ. No. 58--1056-M, 4/16/59; *Schine* v. *Schine*, 250 F. Supp. 822, 823 (S. D. N. Y. 1966).

The "dominating general purpose"[5] of the 1934 Act is to provide for regulation and control of all securities transactions affecting interstate commerce, regardless of by whom, where or how transacted, or whether the securities involved are "negotiable" or have a "fluctuating market". An indication of the scope of the 1934 Act is found in the Act's Preamble, which is not to be confused with §2. The Preamble reads:

> "An Act
>
> "To provide for the regulation of securities exchanges and of *over-the-counter markets* operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, *and for other purposes.*" (Emphasis supplied); (H.R. 9323, Public No. 291-73rd Cong.).

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[5] *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350, 351, (1943), interpreting the definition of "security" in the Securities Act of 1933.

Congressional intent as to both the dominating general purpose and the scope of the 1934 Act is demonstrated by what Congress itself expressly provided in the operative provisions of the 1934 Act.

Congress did not stop with provisions for registration of securities exchanges and with registration of the brokers and dealers who deal in securities on such exchanges and in over-the-counter markets. Its purpose was not limited to regulating and controlling the people in the business of dealing in securities, the securities exchanges and the transactions by those people on such exchanges and in the over-the-counter markets. Congress did provide for such regulation and control and then went on and wrote Section 10 into the Act. Encompassed within Section 10 is *any* person who uses the mails or facilities of interstate commerce in *any* security transaction on or off an exchange.

To insure that no loopholes would occur and frustrate its attempt to reach all fraudulent transactions through Section 10b, Congress provided therein that the SEC may prescribe rules and regulations having the force of law, if the Commission finds them "necessary or appropriate in the public interest or for the protection of investors" in connection with any such transaction. This comprehensive grant of rule-making power to the Commission is persuasive of the "dominating general purpose" of the 1934 Act to regulate and control *any* transaction in "any security" on or off any exchange, by "any person", not excluding non-negotiable securities and those without a "fluctuating market".

It is determinative that in § 10 Congress did not refer expressly as it did in § 2, to transactions in "over-the-counter markets". Instead § 10 places the following in

juxtaposition: "the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." Sub-section b of § 10 similarly speaks only of "the purchase or sale of any security registered on a national securities exchange or *any security not so registered. . . .*" (Emphasis added).

This with finality eliminates any conceivable room for controversy as to the meaning of "over-the-counter market," for Congress has thus twice in § 10 interpreted that term as used in § 2 and in the preamble to mean any transaction involving the mails or related to interstate commerce, other than on an exchange. Section 10 itself manifests "other purposes," the existence of which the preamble signaled. Respondents' notion that the transactions declared unlawful by § 10 are only those involving securities with a "fluctuating market" (CSA Br. p. 15) and only those which are "negotiable" (CSA Br. p. 15) is thus dispelled.

Rule 10b-5 promulgated by the Commission pursuant to § 10(b) (17 C.F.R. § 240.10b-5) is also illuminating, for it too speaks in the same terms and not in terms of "over-the-counter markets." It serves as an early interpretation by SEC shortly after enactment of the Act, and demonstrates that SEC has not changed its views during the pendency of this suit as charged in the Knight Brief.

IV.

Where An Act Is Plain And Unambiguous There Is No Duty Or Right To Resort To Legislative History, But Here The Legislative History Reinforces The Conclusion That These Withdrawable Shares Are A "Security".

The prolix documentation of the Knight brief coats it with a deceptive gloss of authenticity which disappears

immediately upon examination. The brief is all form and no substance.

Both respondents CSA and Knight in their respective Briefs rely heavily on a Mr. Prather as authority for the historical development of the designation "share" for investment interests in savings and loan associations, and for statements as to the legal nature of the investment relationship between an investor and a savings and loan association. Mr. Prather is not an objective commentator, but is a lobbyist for special interests seeking to promote the views he asserts to be the law without benefit of supporting decisions. It is unseemly to cite his writings in the guise of disinterested authority.

In regard to legislative history, the plain meaning of the statute precludes the need for resort to legislative history.[6] In *United States* v. *Oregon,* 366 U.S. 643 (1961), this Court said at page 648 (emphasis added):

> *"Having concluded that the provisions of §1 are clear and unequivocal on their face, we find no need to resort to the legislative history of the Act."*

The words "stock", "certificate of interest in any profit-sharing agreement", "transferable share", "investment contract" and "any instrument commonly known as a 'security' ", are clear, unequivocal and unambiguous.

In regard to the 1934 Act, the statute at issue here, there is a complete absence of any legislative history per-

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[6] *Caminetti* v. *United States,* 242 U.S. 470, 485 (1916) ("Where the language is plain and admits of no more than one meaning, the duty of interpretation does not arise, and the rules which are to aid doubtful meanings need no discussion.'); *Hamilton* v. *Rathbone,* 175 U.S. 414, 421 (1899) (Extrinsic aids may be "resorted to to *solve* but not to *create* an ambiguity.")

taining to the question of whether a withdrawable capital share issued by a savings and loan association was intended to be a security. Although the Knight brief is not entirely clear in this respect, it seems to imply otherwise.[7] In his dissenting opinion below, Judge Cummings said (R. 54-5): "When Congress enacted the Securities Exchange Act of 1934, there was no discussion of savings and loan interests during the consideration of the definition of a security in that act."[8]

In connection with the enactment of the 1933 Act, there was some Congressional discussion of the issue involved in the present case. The Knight brief takes the incongruous position that the legislative history of the 1933 Act is pertinent, but that judicial interpretations of the 1933 Act are not, in interpreting the definition of security in the 1934 Act (Compare, Knight Br. pages 11-13, 36, with same brief pages 22, 39). But even if the 1933 Act history is examined, it leads to the inevitable conclusion that withdrawable capital shares issued by savings and loan associations were intended to be securities (SEC Brief, pages 16-19).

The only matters relied upon by the Knight brief to rebut the overwhelming evidence that withdrawable capital

[7] Pages 18-19: "From the exhaustive analysis of the legislative history of the 1934 Act, Congress was well aware of the type of interests herein at issue. Such interests were discussed, debated and thoroughly considered in Congressional reports, records and hearings." See also, last paragraph of page 15.

[8] The Knight (p. 22) brief appears to agree with Judge Cumming's statement to the effect that ("Possibly the only hint of any Congressional consideration of share accounts with regard to the 1934 Act was the 1963 hearings and the subsequent exemption made in the 1964 amendments") but not until it has strongly implied the contrary.

shares were intended to be securities are two statements by Senator Barkley, in one of which no reference was made to the issues here at hand (p. 16) and in the other of which he read a telegram "from a Kentucky institution" (p. 39). Senator Barkley was not the chairman of the committee handling the bill in the Senate. In *United States* v. *Oregon,* 366 U.S. 643 (1961), this Court said at page 648 (emphasis added):

> "Since the State has placed such heavy reliance upon that history, however, we do deem it appropriate to point out that this history is at best inconclusive. It is true, as the State points out, that Representative Rankin, as Chairman of the Committee handling the bill on the floor of the House, expressed his view during the course of discussion of the bill on the floor that the 1941 Act would not apply to insane veterans incompetent to make valid contracts. *But such statements, even when they stand alone, have never been regarded as sufficiently compelling to justify deviation from the plain language of a statute.*"[9]

See also *McCaughn* v. *Hershey Chocolate Co.,* 283 U.S. 488, 493, 494 (1931).

The Knight brief (pages 17-18, 31-2), as well as the CSA brief (pages 27-8), next rely upon statements made by William Cary, then Chairman of the SEC, and by Mr. Cohen, in hearings held in 1963 upon bills which later became the 1964 amendments to the 1934 Act. In the first place, neither witness was purporting to throw any light on what a Congress thirty years ago had intended to include in the term "securities".

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[9] See also, Frankfurter, *Of Law and Men* (1956) 67: "A loose statement even by a chairman of a committee, made impromptu in the heat of debate, less informing in cold type than when heard on the floor, will hardly be accorded the weight of an encyclical."

Secondly, Mr. Cary, among his impromptu remarks in 1963, when asked in the House Committee why building and loan associations were not covered by the extension of registration requirements proposed as amendments to the 1934 Act, did reply in part as quoted at page 17 of the Knight brief. But without indicating any omission respondents omit Professor Cary's significant caveat, immediately ensuing, reading,

> "May I ask Mr. Cohen to speak to that and maybe Mr. Loomis? *I simply haven't given that any thought.*" (Emphasis added).

It should be further noted that in the first quoted paragraph Professor Cary stated merely that the SEC does not have jurisdiction over building and loan associations *generally,* meaning that SEC does not regulate the operations of such associations as do other Federal regulatory agencies. But that does not mean that Professor Cary believes that anyone effecting a transaction in any security of a savings and loan association through misleading and deceptive devices would find the SEC powerless to seek a remedy under the 1934 Act.

Further, the quoted comments of Mr. Cohen which follow (Knight Br. p. 17-18) disclose that the reason why the securities study project preceding proposal of the 1964 amendments did not include securities issued by savings and loan associations was "because of the number of other areas they were looking at." Thus respondents' inference that the absence of study of savings and loan interests in that project evidences the belief of the Commission that these interests are not securities, is rebutted.

It is further clear from Mr. Cohen's statement (p. 18) that his remarks were directed solely to proposed extension of registration requirements and had nothing to do with the anti-fraud remedies in the 1934 Act. In his off-

hand comments he did not suggest that he had given any thought to the extent of coverage of investment interests in savings and loan shares under such anti-fraud provisions.

It is to be noted that the testimony of Professor Cary provides further evidence that these investment interests are commonly known as shares, for he referred to them as "so-called shares" (Knight Br., p. 31; CSA Br., p. 28). Because a "transferable share" is one of the designations used to define "security" in section 3(a)(10) of the 1934 Act, the views of the chairman of the Commission as to how people refer to these investment interests is pertinent with respect to the catch-all portion of the definition which included "or in general any instrument commonly known as a 'security' ".

Most importantly, when Congress in 1964 amended the 1934 Act, the language it used was clear and unequivocal. Section 12(g)(2)(c) provides:

> "The provisions of this subsection [registration requirements] shall not apply in respect of—
>
> * * *
>
> "(C) *any security,* other than permanent stock, guaranty stock, permanent reserve stock, or any similar certificate evidencing nonwithdrawable capital, *issued by a savings and loan association.* . . ." (Emphasis added). (15 U.S.C. §78*l*(g)(2)(c)).

Respondents have attempted to characterize congressional intention with respect to savings and loan shares under the 1933 Act by means of excerpting a few statements from the hearings on that Act. To the extent that respondents' excerpts accurately reflect the context from which they are taken, they express only one of the numerous points of view presented in those hearings. Examination of the record of the hearings themselves,

reveals that the fragmentary comments respondents have seized upon fail even to express the most prevalent point of view as to share account coverage manifest therein.

Moreover, a reading of the Hearings on the 1933 Act in the light most favorable to respondents' position discloses no more than vigorous airing of conflicting views which the resultant 1933 Act resolved on a basis which provides no aid to respondents.

In determining Congressional intent from the plain meaning of the language used, the most conclusive evidence of the fact that Congress intended in the 1933 Act to include withdrawable capital shares of savings and loan associations within the definition of "security" is the language of the exemption of only certain, but not all, such capital shares from the registration, but not from the antifraud, provisions of that Act. § 3(a)(5) provides:

> "*Any security issued by a* building and loan association, homestead association, *savings and loan association,* or similar institution, *substantially all the business of which is confined to the making of loans to members (but the foregoing exemption shall not apply with respect to any such security where the issuer takes from the total amount paid or deposited by the purchaser, by way of any fee, cash value or other device whatsoever, either upon termination of the investment at maturity or before maturity, an aggregate amount in excess of 3 per centum of the face value of such security), . . .*" (Emphasis added). (15 U.S.C. § 77c(a)(5)).

Thus, even withdrawable capital shares are subject to the registration requirements of the 1933 Act if (1) less than substantially all business of a savings and loan association is confined to the making of loans to mem-

bers or if (2) the association charges a fee of more than 3% of the face value of "such security." See also the House Report quoted in the Knight brief at page 13.

In other words, even if the association has all the characteristics of a savings and loan association, its securities, though identical to CSA shares, are not exempt from registration requirements if the size of the withdrawal fee charge is excessive or too many loans are made to non-members. Yet, the size of the withdrawal fee or the loans to non-members have nothing whatsoever to do with the intrinsic nature of the investment interest involved. Thus, by its final authoritative expression of intent, in the statutory language of the 1933 Act as enacted, Congress exempted securities of *some* savings and loan associations, but from *only some* of the provisions of the Act, namely, the registration provisions.

With this in mind, it is noteworthy that throughout the discussion of savings and loan associations during the Congressional hearings which preceded the 1933 Act, the draftsmen of the legislation, the spokesmen for the savings and loan industry and certain of the legislators, expressed views either treating as settled or directly advocating the inclusion of withdrawable capital accounts within the anti-fraud provisions of the Act. Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., First Sess., pp. 70-73, 77; Hearings on S. 875 before Senate Committee on Banking and Currency, 73rd Cong., First Sess., pp. 50-54, 111.

The distinction between including these interests within all the provisions of the 1933 Act, both registration and anti-fraud provisions, or on the other hand only within the anti-fraud provisions was specifically discussed. The draftsmen wanted to include these interests within both

registration and anti-fraud provisions of the statute. Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., First Sess., pp. 75-76; Hearings on S. 875 before Senate Committee on Banking and Currency, 73rd Cong., First Sess., p. 99. Savings and loan industry spokesmen wanted exemption of these interests from the registration provisions, while emphatically supporting their inclusion within the anti-fraud provisions.

The limited exemption from registration of investment interests in savings and loan associations, as enacted in the 1933 Act, was decidedly narrower than the exemption proposed by industry representatives. Also, no exemption was provided any savings and loan investment interests from the anti-fraud provisions of the 1933 Act. Sections 12 (15 U.S.C. §77*l* and 17 (15 U.S.C. §77q) of that Act make it expressly and abundantly clear that the exemption accorded securities of some savings and loan associations, based on the behavior of management rather than the intrinsic nature of their securities, was not to include exemption for such securities from the anti-fraud provisions of the 1933 Act.

V.

Section 10(b), Containing The Operative Provisions Here Involved, Expressly Covers Any Security Transaction And Is Not Limited To Those Occurring After Original Issuance Of Securities.

Among the miscellany of alleged reasons advanced by respondents why the investment interests here involved are not a "security" within the meaning of the 1934 Act definition, which is all that is before this Court, the Knight brief suggests that petitioners have failed to establish that no remedy is available to them under the

1933 Act (p. 24) and for that reason they have no remedy under the 1934 Act. This is a non-sequitur. Respondents fallaciously contend that the 1934 Act covers only security transactions after the original issuance.

Section 10b and rule 10b-5 stand in stark rebuttal. They expressly cover *any* transaction in any security by any person on or off a securities exchange. Issuers are not excluded from its expressed comprehensive coverage. Apparently, respondents have the notion that once Congress enacted the 1933 Act, either its power to legislate with regard to the same subject matter was exhausted or that the 1933 Act demonstrated that Congress had decided that there would be no supplementary legislation complementing or expanding the remedies of defrauded purchasers where original issuers commit frauds.

There is no public policy against successive Congressional anti-fraud enactments and Congress has been free at all times to not only broaden the scope of such legislation but to reiterate in successive laws the unlawfulness of securities transactions accomplished through misleading and deceptive devices. In the absence of express Congressional provision restricting defrauded purchasers of securities to the remedy available under the narrowest or earliest of the successive enactments the option rests with the defrauded purchaser to employ that remedy, express or implied, which may be best suited to his needs.

The Knight brief posits its argument, that if a remedy is available to petitioners under the 1933 Act there can be none under the 1934 Act, on an outdated statement by Professor Loss (Knight Br. p. 24-25) that the Supreme Court "has yet to consider *any* implied remedy under the SEC Statutes. . . ." But this Court has since held in *J. I. Case* v. *Borak*, 377 U.S. 426, 432-33 (1964) that

there is an implied private cause of action under §14 and Rule 14(a) of the 1934 Act in cases involving violation of the proxy rules, stating:

> "Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission acceptance of the representations contained therein at their face value, unless contrary to other material on file with it. Indeed, on the allegations of respondent's Complaint, the proxy material failed to disclose alleged unlawful market manipulation of the stock of ATC, and this unlawful manipulation would not have been apparent to the Commission until after the merger."

If the volume of work of the Commission in the matter of proxy statements is so great that time does not permit an independent examination of the facts set out in the proxy material, *a fortiori* under Section 10(b) and Rule 10b-5 of the 1934 Act, there is immense need for private enforcement to supplement Commission action. In the immeasurably greater area encompassed by section 10(b) and rule 10b-5, covering any transaction by any person on a registered securities exchange or not on an exchange, the volume of situations requiring scrutiny and possible enforcement is so vast that without private enforcement most violations would go unremedied. The Commission, as in cases under the proxy rules, could not conceivably have the manpower, time or budget to investi-

gate all security transactions on or off exchanges and institute all necessary enforcement proceedings to remedy all violations.

Since *Borak,* a decision has been rendered by this Court in an action for private enforcement of the implied remedy under section 10(b) of the 1934 Act and rule 10b-5 promulgated pursuant thereto. In *Surowitz* v. *Hilton Hotels Corporation,* 383 U.S. 363 (1966), this Court in holding that the Federal Rules of Civil Procedure were intended "to get away from some of the old procedural booby traps" (p. 373), stated that "it is not easy to conceive of anyone more in need of protection against such schemes than little investors" like the petitioner there (p. 371). The order of dismissal was reversed and the case remanded to the District Court for trial with the comment that it was time the defendants be compelled to admit or deny the charges in the Complaint. *Surowitz* was necessarily a holding by implication that there is an implied private remedy under section 10(b) of the 1934 Act, in favor of a defrauded purchaser of securities.

These two decisions of this Court, both cited by the present petitioners in prior briefs, establish that the citation of Professor Loss' treatise by respondents is outdated and inapposite.

VI.

There Is No Public Policy Against Cumulative Federal Enactments Of Anti-Fraud Laws Relating To Security Transactions.

The suggestion that there is some public policy *against* providing federal remedies for defrauded purchasers of securities permeates all three briefs of respondents. This type of limited control, triggered only by an act of deception in a securities transaction, is confused by respondents

with general regulation of operations of savings and loan associations by state and other federal regulatory agencies.

Respondents premise their argument on the erroneous comment that if a savings and loan association is not in liquidation, a question under section 10(b) could never arise. They say that anyone can withdraw his money at will from any association which is not in liquidation. That, of course, is untrue. It ignores the fact that almost universally in the United States such shares are only conditionally withdrawable, for savings and loan associations have the right unilaterally to limit or stop withdrawals if they have insufficient cash. Such restriction does not constitute a default, if the amount of investors' shares plus liabilities to creditors does not at the time exceed the total value of assets. (Pet. Br. p. 7-8 and footnote 7). In Illinois an association may (but need not) honor withdrawal requests. (Pet. Br. p. 7; § 773(a)).

In CSA the cause of action under section 10(b) arising from deception in the sale of shares to petitioners existed long before the liquidation started. It was fraudulently concealed until shortly after June 26, 1964. Through such concealment petitioners were effectively denied the information which would have caused them to demand their money, and there is nothing in the record to justify the assertion of respondents that requests for withdrawals were honored by CSA, for they were not.

VII.

Archer & Co. v. SEC Demonstrates That As Early As 1943 The 8th Circuit And The SEC Interpreted Withdrawable Investments In A Savings And Loan Association To Be A "Security" Subject To The 1934 Act. The Correct Interpretation By The District Court Here Was Not Novel.

The Knight brief attempts to distinguish the case of *Archer & Co. v. SEC*, 133 F 2d 795 (CA 8, 1943) cited

by petitioners (Pet. Br. 38), by speculating that the investment interests there involved were face amount certificates, rather than share accounts. (Knight Br. 22-23, footnote).

That ignores footnote 17 at page 13 of Petitioners' Reply Brief to Briefs in Opposition to Petition for Writ of Certiorari. It discloses that petitioners were advised that the certificates of Pacific States Savings and Loan Association involved there, actually represented withdrawable capital. This information, as stated, came from state officials in the Division of Savings and Loans of the Department of Investments of the State of California. Respondents' speculation is no proper rebuttal. Respondents do not claim they have any contrary information, but rest on pure speculation from what they argue "appears" in the report of the decision in *Archer*.

From that point, footnote 51 in the Knight brief proceeds to utter confusion. It surmises that the certificates there involved are contemplated under the Investment Company Act of 1940, but the violations in *Archer* occurred in 1937, three years earlier. Then it asserts that there is no indication that Pacific States Savings and Loan Association was a true building and loan association which made loans only to its members. That refers to the exemption provided in section 3(a)(5) of the 1933 Act. But that is completely inapplicable because SEC sued Archer for violation of section 15 of the 1934 Act. Loss of exemption from registration provided to some associations under the 1933 Act, was not in any way involved in *Archer*.

The CSA brief (p. 28) in turn argues that *Archer* involved more than savings and loan association certificates, because the Court's holding was also based on

fraudulent sales of common stock in violation of the 1933 and the 1934 Acts. What the CSA brief fails to comprehend is that there was an explicit finding in the *Archer* decision that the transactions in the certificates in question constituted a violation of the 1934 Act. (*Archer & Co. v. SEC,* 133 F 2d 795 (CA 8, 1943), at 801).

Implicit in that finding is a holding that the withdrawable capital certificates of Pacific States Savings and Loan Association were securities under the 1934 Act, otherwise that court could not have held as it did. The suggestion at page 28 of the CSA brief that the decision contains no indication that the Court was asked to hold whether the certificates in question were securities, ignores the precise holding of the court that the transactions in these Pacific States certificates violated the 1934 Act. (p. 801).

VIII.

Additional Evidence That Withdrawable Interests In Savings And Loan Associations Have Been "Commonly Known As A 'Security'" Prior To And Since Enactment Of The 1934 Act Is Supplied By Respondents' Own Briefs.

Even greater confusion exists in respondents' efforts to avoid the catch-all clause, "or in general, any instrument commonly known as a 'security'." Except for a casual reference, it might appear that respondents overlooked the comprehensive coverage of this point in Part II of petitioners' Brief (pp. 28-40). It includes numerous citations to broad usage in Illinois and elsewhere which respondents have been unable to refute, demonstrating that these interests have been "commonly" so regarded.

It may be recalled that the pivotal holding of the lower Court on which its finding turns that these interests are

not "commonly known as a 'security'" (R. 47), is based on a misconception of the Illinois Act. (Pet. Br. 29 et seq.). That was due to the Court's error in finding significance in respondents' argument that section 2 of the 1934 Act establishes that it applies only to "negotiable" securities as distinguished from investment interests which are "transferable by assignment."

It is natural that the Illinois legislature would except from the operation of the Commercial Code securities article dealing only with negotiable securities, the non-negotiable securities of Illinois savings and loan associations. But that is far from providing that these are not securities.

Petitioners' brief cites a very respectable number of Illinois statutes enacted over many years, some at a time when withdrawable capital accounts (shares and share accounts) were the only type of investments in savings and loan interests permitted by Illinois law. In certain instances the word "securities" was used to designate these interests as exempt, as in the Commercial Code and in the Illinois Securities Act. (Pet. Br. p. 30-1). In others, the legislature used the terms "securities" or "shares" to denote these interests for the purpose of authorizing investments therein.

Yet respondent CSA contends that these Illinois Acts are "plainly irrelevant to the issue at bar" because (a) the sections of statutes cited by petitioners are non-definitional in character, and (b) "when these Acts were passed, the Illinois legislature did not at all consider the question in this case . . . .". But in situations where the word "securities" was used to identify these investment interests in the years before Illinois associations were authorized to issue other types of investment interests,

the various Acts necessarily were definitional, for they could only have been referring to the type of interests here involved.

As to the second objection, that the Illinois legislature did not consider the question in this case and therefore those statutes are irrelevant, this too is without substance. The relevance here is to whether these interests are "commonly known as a security," which they very definitely were and have been considered over many years prior to passage by Congress of both the 1933 Act and the 1934 Act, and up to the present time. The inference in the CSA brief that petitioners' citations are irrelevant unless the Illinois legislature considered the question involved in this case, viz., the application of the 1934 Federal Securities and Exchange Act, necessarily imports the absurd contrary inference: that the Illinois legislature could pass an Act determining which investments should and which should not fall within the scope of a Federal Act. But that does not mean that in determining whether these interests have been "commonly known as a 'security'," the answer may not be gleaned from Illinois legislation through the years, as well as from other local and national resource material. This has been done by petitioners' brief (pp. 28-40), which establishes that these investment interests are commonly considered a security.

The CSA brief (p. 20) quotes from the House Judiciary Committee's Report on the Bankruptcy Act, 72nd Cong. (1931). Twice in the 4th line of that quotation it identifies this type of investment interest as "securities." Thus three years before passage of the 1934 Act, that Committee considered the word "securities" as the proper way to designate these interests to readers of its Report.

The CSA brief (p. 28) quotes the hereinabove cited 1963 testimony of Professor Cary, the chairman of the SEC, in which he stated that the reason section 12(g)(2)(c) of the proposed [1964] amendments provides for exemption of this type of "share" from proposed extension of registration of securities is that "most savings and loan associations issue *so-called shares.*" (Emphasis added). The word "securities" is used by Congress to identify these investment interests in savings and loan associations as being among those exempted from such registration requirements. The same usage occurred in the 1933 Act partial exemption.

Again, at page 10 of the CSA brief, reference is made to Mr. Prather's writings hereinabove mentioned. He is cited as authority that "Throughout the United States it has been held that ownership of accounts in savings associations constitutes not the ownership of 'shares of stock' . . . ." It is quite evident that it has *not* so been *held* "throughout the United States," for there are only a handful of decisions in a few States involving special situations having no pertinence here, such as applicability of tax statutes. The citation of Prather is illuminating, indicating absence of any authority which could be used in rebuttal of part II of petitioners' brief (pp. 28-40).

The Knight brief (p. 28) also cites Prather, and refers to his article in 15 Business Law, 44-69 (1959). That citation has significance only because Mr. Prather there expressly refers to these interests as "debt *securities*" (p. 44). (Emphasis added).

The Knight brief (p. 39) quotes a telegram from a Kentucky institution read at the 1933 hearings in opposition to regulation of investment interests of the type here under consideration. To identify the investment

interests which they wished excluded from regulation, the senders of that telegram used the word "stock," another of the terms which the 1934 Act definition identifies as a "security" thereunder.

The foregoing comments are necessarily only symptomatic of the shortcomings of respondents' briefs.

CONCLUSION.

The dissenting opinion of Judge Cummings represents the correct solution to the questions presented by the interlocutory appeal. The essentials of petitioners' Brief and of the Amicus Brief filed by the Securities and Exchange Commission have not been met by respondents in this Court. It is respectfully urged that the judgment of the Court of Appeals be reversed.

Respectfully submitted,

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November 1967.